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National City Monthly Letter on Business and Economic Conditions

New York, March, 1954

General Business Conditions

THE month of February is usually expected to bring a slight rise in industrial operations, in preparation for spring business, but this year there has been little of even seasonal improvement. The policy of limiting commitments and reducing inventories still dominates the markets. It is being carried out in orderly fashion by holding purchases below shipments, without significant financial pressure or distressed liquidation. Final consumption of goods and services has held up well. Prices remain stable. However, backlogs of unfilled orders have been cut further. Industrial production in the aggregate appears to be holding close to the end-of-January level, but after seasonal adjustment the production index for February will show about the same decline as in previous months.

Probably many people were surprised by the testimony of a Federal Reserve Board official, Winfield Riefler, given February 16 before the Joint Congressional Committee on the Economic Report, that industrial production is now 10 per cent below its July, 1953, peak. This means that the contraction in output up to this time has been as large as the entire decline during the 1949 recession. In fact, it has proceeded somewhat faster. Mr. Riefler's estimate implies a February index of industrial production of roughly 123 (1947-49 = 100), compared with 125 in January and the peak of 137 last July.

The Bureau of the Census released during the month the results of a new sample survey – as yet tentative and unevaluated – which indicates that both the labor force and the number of unemployed were 700,000 greater in January than previously estimated. The new figure for unemployment, early in January, is 3,100,000. No comparative figures for earlier periods are available; hence, it is not clear whether this indicates a higher level of unemployment during 1953 than was originally reported, or a more rapid rise from the postwar low of last fall. Total employment and nonagricultural employment, however, were approximately the same in both sets of estimates. The unresolved question is whether people have in fact dropped voluntarily out of the labor force as employment opportunities lagged, or whether they still want work.

Inventories Dropping

The other side of the contraction in industrial output and employment is that inventory reduction also is proceeding at a good pace. The last issue of this Letter quoted the President's Economic Report as indicating that inventory accumulation ceased last September, and that stocks were unchanged during the final quarter of 1953. An official revision of these estimates, however, indicates that business stocks actually were liquidated during that quarter at a seasonally adjusted rate of $3 billions a year (and by an even greater amount if the downward revaluation of inventories is also taken into account).

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Reduction of stocks is almost certainly continuing. This is the process by which the industrial decline in due course will be checked, provided consumption holds relatively well. The steel mills, operating at about 74 per cent of capacity during February, are confident that steel stocks in processors' hands are being worked down; and while no significant upturn is expected immediately, scattered increases in orders suggest that the markets are settling down and that little further drop in operations is likely. Some textile manufacturers report increased inquiries and firming prices and think they can see daylight ahead. Cotton yarn manufacturers reported increased order backlogs for the first time in six months.

In the automobile industry, on the other hand, production has been less than expected, in part because dealers' stocks are large and in part because retail sales have been sluggish. Statements made by some leading companies around the first of the year indicated that first quarter output might even exceed the 1953 level. But earlier schedules have been cut back. Sales in January were not only lower than a year ago but less than in December, after allowing for the usual seasonal change. In relation to sales, stocks of new cars are the highest in a great many years. This may not be of as much consequence as it seems, since the big selling season lies not far ahead, but it is a damper both on current output and on the automobile industry's purchases of materials and parts.

Sentiment Continues Good

Despite the recession, most observers agree that business sentiment is showing little change, and that little fear of a spiralling decline into depression is apparent. The necessity for inventory adjustment, reduction of costs through improved productivity and elimination of waste, and aggressive effort to meet new market conditions, has been accepted as inevitable. For the long run a tightening up of this kind will strengthen the business organization and lay a base for resumption of the upward trend. Business men are addressing themselves to these problems with general confidence in the long-run outlook.

It would be hard to find a case where programs for research and development, or for improvement of plant and equipment, have been cut back because of market or financial conditions; on the contrary, numerous companies indicate that their capital budgets for 1954 are larger than for 1953. The confidence with which the automobile business faces the future, illustrated in January by the revelation of General Motors' billion dollar program, was underscored March 1 when L. L. Colbert, president of the Chrysler Corporation, announced that his firm was borrowing $250 million for the purposes among others of expanding and modernizing facilities, improving productivity, and increasing working capital.

The Administration's tax program gives support to private investment and spending, counteracting curtailment of defense outlays. Money markets are easy, security markets buoyant, and new financing active. Machine tool orders in January showed a moderate improvement. Construction shows no abatement. In January both outlays for new construction and contracts for projects to be built in the months ahead (as collected by F. W. Dodge) were the highest for any January on record. Even with respect to the short-term outlook, over three quarters of the business men questioned by Dun & Bradstreet in mid-January expected their sales in the second quarter to equal or surpass a year ago when business generally was at record levels.

Outlook for Consumer Buying

Undoubtedly a basic reason for this confidence is the belief that consumer buying will hold up. The seasonally adjusted sales of all retail stores other than automotive dealers in January of this year were at approximately the same rate as in December or in January 1953. Department store sales in the first seven weeks of the year were within 1 per cent of the opening weeks of 1953 and slightly ahead of the same period in 1952.

These figures give evidence that consumers will respond to attractive offerings. Since prices have been relatively stable for some time, people see little reason to postpone purchases and wait for price declines. Although unemployment is higher and overtime pay lower, the consumer who cannot afford to buy is not, at this time, a major problem. The decline in wage payments is cushioned in some degree by tax reduction, unemployment compensation, accumulated savings, and other influences which help stabilize disposable income. Thus the job is to attract consumers who have money with which to buy if they choose.

Throughout the postwar period the drive to improve living standards has been a powerful force in the economy. Consumers have been reluctant to curtail their spending, except in cases of prolonged unemployment or a drastic general decline in business. In 1948-49 consumers

actually increased their spending during a period of moderately declining income, through saving less. On the whole, individuals did not reduce their liquid asset holdings at that time; they merely added to them at a slower rate. Whereas 5.6 per cent of disposable personal income was saved in 1948, only 3.6 per cent was set aside in 1949. In the latter part of 1953, however, when the contraction was already under way, the rate of saving actually rose. The 7.7 per cent of disposable income saved in the fourth quarter of 1953 constitutes both a cushion for consumers and a challenge to sellers.

It is too much to expect that consumer expenditures will increase as they did in 1949, for in that year the shrinkage in incomes derived from private production and demand was largely offset by increased government purchases of goods and services, which are not anticipated this year. Nevertheless, it is plain that consumer purchasing power does not follow the industrial production index down at anything like the same rate or to the same extent. As long as demand holds up relatively, an increase in orders and output will eventually take place, if only to fill the gap between production and consumption now being met by drawing down inventories.

Corporate Earnings in 1953

Annual reports issued by leading corporations for the year 1953 show that sales and earnings continued in most cases at high levels accompanying the high rate of business activity that prevailed during most of the year. The record-volume corporate operations are reflected in all-time peaks in the dollar totals of manufacturers' sales, retail trade, transportation and public utility services, and new construction, as well as in national income distributed in the form of wages and salaries, nonfarm proprietors' and rental income, interest, and dividends.

Our tabulation of the annual statements for 1953 published to date by 2,359 corporations in all major lines of business shows combined net income of approximately $9.9 billion after taxes, compared with $9.0 billion in 1952, an increase of 10 per cent. About two out of three companies reported increases. The condensed summary below shows the trends by main industrial divisions.

Preliminary Summary of Net Income of Leading Corporations for the Years 1952 and 1953
(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income After Taxes 1952	Reported Net Income After Taxes 1953	Per Cent Change
112	Food products	$ 266,111	$ 296,047	+11
87	Beverages	94,948	93,608	— 1
17	Tobacco products	110,258	128,190	+16
80	Textile products	78,364	100,368	+28
22	Clothing and apparel	12,048	13,741	+14
21	Shoes, leather, etc.	19,838	26,821	+36
17	Tires, rubber products	159,566	181,152	+14
27	Lumber, wood prod.	70,175	72,566	+ 3
48	Paper and allied prod.	183,639	191,420	+ 4
53	Chemical products	572,251	603,768	+ 6
23	Drugs, soap, cosmetics	126,695	127,218	+—
15	Paint and varnish	50,872	60,711	+19
52	Petroleum prod. & ref.	1,427,993	1,524,706	+ 7
56	Cement, glass, stone	170,335	183,992	+ 8
39	Iron and steel	517,493	714,585	+38
345	Other metal products	1,109,923	1,125,135	+ 1
87	Transportation equip.	312,785	350,745	+12
52	Misc. manufacturing	78,727	87,162	+11
1,103	Total manufacturing	5,361,516	5,881,430	+10
16	Coal mining	27,390	14,398	—47
8	Metal mining	11,146	12,184	+ 9
5	Other mining, quarry.	10,281	12,002	+17
29	Total mining, quarry.	48,817	38,584	—21
18	Chain stores—food	45,478	59,511	+31
83	Chains—variety, etc.	98,821	97,313	— 2
39	Department & specialty	94,752	99,424	+ 5
45	Wholesale and misc.	104,962	95,268	— 9
185	Total trade	344,013	351,516	+ 2
131	Class 1 railroads	836,000	875,000	+ 5
40	Other transportation	59,025	58,267	— 1
171	Total transportation	895,025	933,267	+ 4
155	Elec. power, gas, etc.	824,347	920,658	+12
49	Telephone & telegraph	446,020	540,721	+21
204	Total public utilities	1,270,367	1,461,379	+15
12	Amusements	20,811	17,693	—15
25	Restaurant and hotel	11,496	14,245	+24
19	Other business services	41,950	46,668	+11
13	Construction	17,826	18,719	+ 5
69	Total amuse., services	92,083	97,325	+ 6
328	Commercial banks	597,674	662,055	+11
22	Fire & casualty insur.	56,815	68,260	+20
173	Investment trusts	249,040	277,806	+12
61	Sales finance	110,275	126,345	+15
64	Real estate	19,131	14,086	—26
648	Total finance	1,032,935	1,148,552	+11
2,359	Grand total	$9,044,756	$9,912,053	+10

Trends in Manufacturing

In the statements of 1,103 companies in the manufacturing industries the combined net income was up 10 per cent. This contrasts with an 18 per cent increase shown last November in our tabulation of manufacturers' reports for the first nine months of 1953.

Some of the gains in sales and earnings for the full year 1953 were in the nature of recovery from the effects of the prolonged steel strike in the summer of 1952. Net income of 39 reporting steel producers was up 38 per cent. Likewise, many steel-consuming companies, whose supplies and operations had been curtailed in 1952, scored marked recoveries.

In addition, numerous companies in diverse lines obtained relief from the squeeze on profit margins after OPS ceilings on selling prices were terminated early last year. Other companies that had experienced a slump in 1952 enjoyed a rebound in 1953, including textiles, clothing, leather and shoes, rubber products, and paint. Other gains reflected primarily a continued growth in production and sales.

Another favorable factor of widespread application last year was the effect of the expansion and the modernization of plant and equipment that has been taking place.

Net sales of the larger manufacturing organizations thus far reporting for last year were up about 11 per cent. There was an increase of 17 per cent in pre-tax earnings, of which income and excess profits taxes absorbed 57 per cent in 1953, against 55 per cent in 1952. Such federal taxes in dollars were up 21 per cent.

Not yet available for this preliminary summary are the figures of important organizations in many lines, particularly in foods, petroleum, automobiles, aircraft, nonferrous metals, and retail trade. Reports by most of these companies to be issued during March will be included in the detailed summary in our April issue, which will show earnings by 70 major industry groups together with average rates of return on net assets and profit margins on sales.

Balance Sheet Changes

A comparison of the December 31, 1953 balance sheets issued to date by 150 of the larger manufacturing companies shows that the most important use of funds last year was for continued heavy expenditures on plant and equipment. Changes in the principal asset and liability items may be seen from the accompanying composite statement, which gives comparative figures for 1940 and 1945. These companies had sales last year of approximately $21 billion.

Composite Balance Sheet of 150 Manufacturing Companies with Sales or Total Assets over $5 Million

(In Millions of Dollars)

Assets	1940	1945	1952	1953
Cash	$ 600	$ 809	$1,132	$1,111
Government securities†	62	761	1,248	1,391
Receivables, net	474	858	1,799	1,724
Inventories*	1,157	1,790	4,054	4,096
Total current assets	2,298	4,218	8,233	8,322
Land, plant and equipment	3,621	4,081	8,343	9,185
Less depreciation & depl.	1,779	2,488	3,859	4,246
Net property	1,842	1,593	4,484	4,939
Other assets	471	408	577	653
Total assets	4,606	6,219	13,294	13,914
Liabilities and Capital				
Notes payable	56	198	353	449
A/c pay., accruals, etc.*	347	638	1,581	1,427
Reserve for taxes†	231	713	1,403	1,520
Total current liab.	634	1,549	3,337	3,396
Bonds, notes, etc.	533	425	2,089	2,146
Reserves	84	171	235	235
Capital and surplus	3,355	4,074	7,633	8,137
Total	4,606	6,219	13,294	13,914
Working capital	1,659	2,669	4,896	4,926
Ratios:				
Cur. assets to cur. liab.	3.62	2.72	2.47	2.45
Cash & govts. to cur. liab.	1.04	1.01	0.71	0.74
Equity cap. to total liab.	2.87	2.06	1.41	1.47

† Before deducting tax notes offset against taxes payable.
* Includes advances on government contracts.

It will be seen that the increase in gross property account was $842 million, but that this was offset to the extent of $387 million written off for depreciation and depletion, leaving an increase in net property of $455 million.

Of the $620 million expansion in total assets, $504 million or five-sixths was obtained from a building up of capital and surplus. Such increase came mainly from the retention of earnings, only about 56 per cent of which (after taxes) was paid out in dividends. There were increases in short-term notes payable as well as in long-term bonds, notes and mortgages.

There was a substantial rise in tax reserves, amounting for this sample of companies to $117 million. Such liability consists to a preponderant extent of federal income and excess profits taxes for 1953, of which 90 per cent is payable during the first two quarters of 1954. This contrasts with 80 per cent payable in the first half of 1953, and only 50 per cent in the first half of the years prior to 1951 when the statutory step-up went into effect.

Meeting such heavy tax payments on the 15th of March and of June this year might create for some companies a shortage of cash and necessitate temporary bank borrowing. Although the combined statement shows that cash plus government security holdings, including tax notes, exceed the total tax liability, such composites always conceal wide differences among individual companies. By 1955 the portion of the previous year's taxes payable in the first two quarters will rise to its maximum of 100 per cent.

Discount Rate Reduction

Effective February 5, the discount rates of the Federal Reserve Banks of New York, Boston, Philadelphia, St. Louis and San Francisco were lowered from 2 per cent to 1¾ per cent. The other Reserve Banks, as their boards of directors met to consider the question, followed with corresponding rate changes, and by February 15 1¾ per cent had become the standard rate which member banks throughout the country pay on borrowings from their Reserve Banks. This restores the rate in effect from August, 1950 up to January, 1953, when the 2 per cent rate was set.

Some observers expressed surprise that the rate should have been cut at this time, considering the high level of business and the moderation of the previous 2 per cent rate. Although the authorities issued no public statement explaining the action, the rate cut was generally interpreted as a further step to insure a plentiful supply of loan funds, to guard against any spiral-

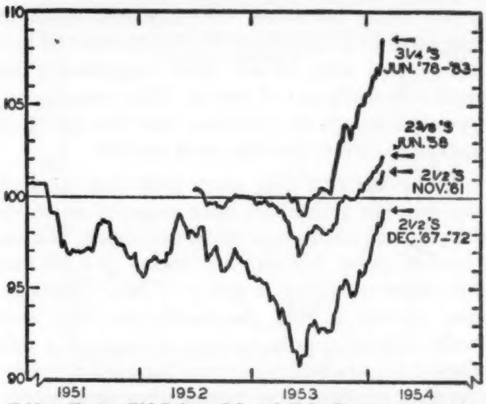
ling contraction in business and employment, and to adjust the discount rate to a more logical position in the structure of open market money rates that had developed as a result of releases of funds into the market by Federal Reserve purchases of government securities.

Open market money rates have fallen to the lowest levels in years. For example, yields on weekly issues of 91-day Treasury bills, which averaged 2.20 per cent during the second quarter of 1953, averaged 1.48 per cent during the fourth quarter and so far this year have ranged from 1.34 per cent all the way down to 0.89 per cent, lowest since 1947. The rate paid by the Treasury for one-year money has dropped from 2⅝ per cent last summer to 1⅝ per cent, lowest since 1950. Prime 4-6 months' commercial paper has declined in successive ⅛ per cent steps from 2¾ per cent to 2 per cent, lowest in three years.

Rates charged on customer loans, which had risen only moderately during the money pinch last spring, have held fairly steady, though banks are more receptive to loan applications than they have been in several years. Partly for this latter reason, and despite payoffs of business loans undertaken to carry inventory and to save on excess profits tax liability, total bank loan volumes so far this year have held above the levels of the corresponding period of 1953. Business loans of weekly reporting member banks in the first seven weeks of 1954 have averaged only 2 per cent below last year; real estate loans have averaged 6 per cent higher, loans to security brokers and dealers 23 per cent higher, and consumer and other loans 8 per cent higher. Total loans for these banks so far this year have averaged 3 per cent above January-February, 1953.

Bond Market

The conditions of ease in the market for short-term borrowings contrast with the strain evident during the money squeeze last spring. The change in the long-term market is just as striking. As indicated in the chart, the thirty-year 3¼ per cent bonds sold by the Treasury last May rose during February as high as 108¾, dropping the yield to the buyer to 2¾ per cent. The Victory Loan 2½s of 1967-72, quoted as low as 89⅞ last June, reached a level of 99⅝. New corporate, State and municipal bond issues have been absorbed in substantial volume at rising prices. For example, in February $60 million Pacific Gas and Electric Company 31-year mortgage bonds were offered to investors at a yield level of only 3.07 per cent; last May similar obligations of the same company were sold to yield 3.90 per cent.



Friday Closing Bid Prices, Selected U.S. Government Bonds

The improved supply of money for investment in real estate mortgages is evidenced by the fact that the Federal National Mortgage Association ("Fannie Mae") has been able to raise its asking price on 4 per cent Veterans Administration guaranteed mortgages from 96 to 98 cents on the dollar and Federal Housing Administration insured 4¼ per cent mortgages from 97¾ to 99¾ cents on the dollar. Indeed, one of the main effects of the shrunken yields on bond investments is to press funds upon the mortgage market where much better returns are offered. The building boom is in no risk of foundering for lack of funds. The risk rather could be that home-building will expand to a scale that cannot be sustained.

Workings of Policy

One of the most dramatic changes in Federal Reserve policy in recent years has been the withdrawal of the Reserve Banks from dealings in government bonds. From 1947 to 1951, when bond price pegs were removed, their most significant transactions were in long-term bonds. Now, in contrast, their dealings in government securities are being restricted almost entirely to 91-day Treasury bills. Thus, the Federal Reserve does not directly affect bond prices. The indirect effects, however, transmitted through the banking system, can be powerful as the experience of the past year demonstrates.

A Federal Reserve purchase of Treasury bills, for example, gives the holder cash which is likely to be deposited with a bank. The same action tends to depress yields on such obligations and to discourage customers from placing idle funds in short-term investments. The lower yields and bigger deposits give banks incentive and means to take on more loans. They also lead banks to bid for intermediate and longer-term bonds. The resultant higher prices and lower yields on

bonds invite insurance company and other investors to look elsewhere for investments of new money and also afford them opportunity for profitable shifts out of bonds. Thus easy money spreads through the markets, into the mortgage market and even into the stock market.

This is the first time since 1949 that the Federal Reserve authorities have engaged in an all-out effort to encourage credit expansion, and the question many bankers are asking is how long this phase of policy is going to last. The common answer is that the authorities will keep credit in easy supply so long as fears of a substantial drop in business persist or until excessive spending of borrowed money threatens to produce another inflationary surge.

Treasury Refunding Results

Perhaps to avoid criticism that the action was designed to help the U.S. Treasury meet its financing problems, the discount rate change was not announced until after the subscription books had closed on the Treasury's huge February refunding operation. In any case, the refinancing did not require any special aids. Of the new seven and three-quarter year 2½ per cent bonds due November 15, 1961, no less than $11.1 billion were placed with investors, creating the largest single issue of government bonds outstanding. The new 2½s traded at 100½, when issued, during the period the exchange subscription books were open, and fluctuated in a range from 100⅝ to 101⅜ after the discount rate cut was announced.

Of the $11.1 billion new 2½ per cent bonds, as the table indicates, about half were taken by the holders of certificates and notes maturing February 15 and March 15. The other half was taken by holders of the three bond issues maturing or called for payment June 15. Other holders of the February and March maturities, including the Federal Reserve Banks, accepted an alternative offer of 1⅝ per cent one-year certificates maturing February 15, 1955. Only $177 million of the February and March maturities, which had totalled $12.8 billion, were left unexchanged requiring cash redemption.

More than two-thirds of the three June bond maturities, outstanding in the total amount of $8 billion, were converted into the new 2½s. In June the Treasury will make a further — and final — exchange offer for the bonds left outstanding. But the February refinancing reduced the overall size of the June refunding problem from $12.9 billion to $7.3 billion. This $7.3 billion is made up of $4.9 billion certificates of indebtedness due June 1 and the residual $2.4 billion of the three bond maturities.

February 15, 1954 Refunding Results

(Dollar figures in millions)

	Certificates due 2/15	Notes due 3/15	Bonds* due 6/15
Public holdings	$4,426	$4,440	$7,458
Exchanged for 2½% bonds	2,367	3,233	5,567
Exchanged for 1⅝% cert.	1,957	1,132	†
Requiring cash redemption	102	75	†
% exchanged for bonds	*54%*	*73%*	*75%*
% exchanged for cert.	*44%*	*25%*	†
% requiring cash redemption	*2%*	*2%*	†
Federal Reserve holdings	8,688	235	549
Exchanged for 2½% bonds	0	0	0
Exchanged for 1⅝% cert.	8,688	235	†

*2s of June 15, 1952-54; 2¼s of June 15, 1952-55; 2¼s (partially tax exempt) of June 15, 1954-56.

†Certificates were not offered to holders of the June bond maturities. They can expect to be given an opportunity to exchange for short-term obligations in June.

The signal success of the February refunding — the largest ever attempted or achieved — is a reflection as much as anything of the pressure the easy money policy places on banks to improve returns realized on government security holdings by lengthening out maturities. This involves no locking up of loan resources since the new bonds are salable in the present market at a premium above cost. On the other hand, the lengthening out process will tend to make the banks more sensitive to measures which the authorities may apply at some later time to restrict credit. Restriction of credit supply depresses market prices of bonds, and the availability of credit to borrowers is limited by the lenders' reluctance to take losses.

The Rise in Coffee Prices

The spectacular rise in the price of coffee has stirred up considerable excitement among housewives, consumers, and politicians in this country. Considering the immense number of Americans who drink coffee, this furor is not altogether surprising. Rising prices always evoke protests from consumers, and such protests are likely to be particularly uninhibited when the products come from abroad. Foreign producers always can be denounced with more impunity than producers at home.

The present situation in coffee illustrates again the tendency of many people to see skulduggery in sharp commodity price movements, rather than reflection of natural shifts in supply-demand relationships. Charges have been made that price rises are the result of "speculation", of Brazilian hoarding of coffee supplies, and the like. These charges have been denied, both by the people in the coffee trade and by the public authorities in Brazil and other coffee-growing countries. They contend that the price rise is the

result of a gradually tightening supply-demand position, topped off by serious damage to Brazilian coffee trees last July (the winter period in the Southern Hemisphere) which sharply reduced the exportable surplus of the 1953-54 crop and seriously hurt prospects for the 1954-55 crop.

Nevertheless, in consequence of all the clamor, both the Administration and the Congress have launched investigations. The Federal Trade Commission at President Eisenhower's request is looking into trading on the New York Coffee & Sugar Exchange. A Senate Banking subcommittee has been conducting its own inquiry into the cause of the coffee price rise, while the Senate itself – without waiting for the results of either of these two investigations – has resurrected, approved, and sent to the House an old bill of Senator Gillette's (Iowa), long pigeonholed in the Agricultural Committee, subjecting coffee trading to the same federal supervision that applies to most of the other commodity exchanges.

There is need for calm appraisal of the situation. If, as the coffee trade maintains, the rise in prices is due to the law of supply and demand, then putting coffee trading in this country under federal regulation won't help matters. Attempts to keep the price down artificially in this market not only may, as pointed out by the New York Times, "worsen our position by encouraging diversion of supplies to countries willing to pay more," but also tend to impede the working out of the real cure through higher production.

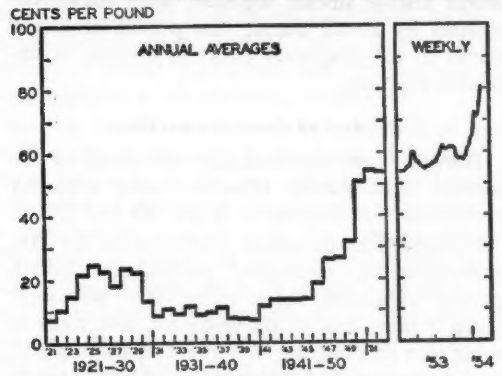
Meantime, the reiteration of intemperate and ill-founded accusations of price-gouging can only do harm in fostering bad feeling between the American public and their friends in the coffee-producing countries.

Long-range Influences on Coffee Prices

Actually, the basis for the current rise in coffee prices becomes plain enough from an examination of the world supply and demand situation now and going back over the years.

In the accompanying chart we trace the course of spot wholesale green coffee prices in the New York market from 1921 to date as represented by Santos No. 4, the leading Brazilian type.

The chart shows the latest rise in coffee prices, amounting to around 25 cents per pound since November – when the effects of the July frost damage in Brazil became better known – and carrying the price to an all-time high around 82 cents. Retail prices of many brands of coffee, which include costs of roasting, transportation,

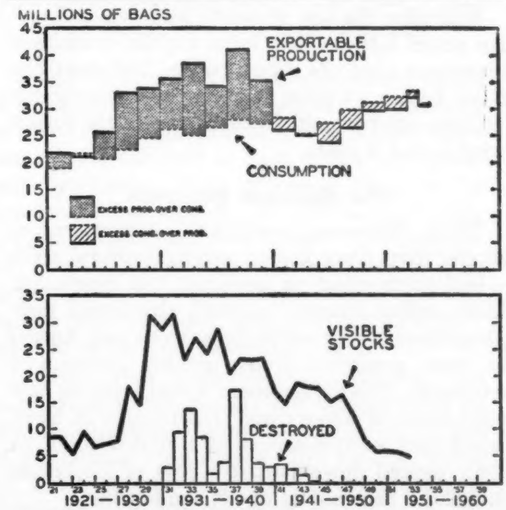


Spot Prices of Wholesale Green Coffee, Santos No. 4, at N. Y.

packaging, as well as normal wholesale and retail markups, have risen well above $1.00 per pound.

The chart shows the rise in wholesale prices as an extension of a marked advance since the end of the war. This follows a long period of depressed prices after relatively high prices in the '20s.

To the perceptive reader, the protracted depression of the '30s and early '40s may in itself suggest the basis for the price recovery and boom of the late '40s and the '50s. The picture, however, is much clearer in the next chart, showing (1) in the upper panel, estimated world production and consumption of coffee by two-year periods (to average out Brazil's alternating large and small crops); and (2) in the lower panel,



World Exportable Production and Consumption of Coffee, by Two-Year Periods (annual averages); Visible Stocks in Producing Countries, July 1; 1921-1953. Coffee Destroyed by Brazil, 1931-1944.

world visible stocks, together with coffee destroyed by Brazil during the period of excess stocks in the desperate effort to dispose of unsalable supplies.

Period of Overproduction

Here we see unmistakably the seeds of the present tight market situation being sown by overproduction developed in the '20s and '30s.

Influenced by favorable prices during the '20s, coffee-growing countries, particularly Brazil, greatly expanded their coffee tree plantings. Since it takes five to six years for new trees to come into full bearing, the effect of these plantings on output and prices was not felt immediately. By the late '20s, however, production was pulling ahead of consumption. This is shown by the shaded area of the upper panel of the chart, and by the upturn in visible stocks in the lower panel.

This condition of unbalance grew steadily worse in the '30s, with a tapering off in the rise of consumption adding to the difficulties. For the ten crop years 1929-30 through 1938-39 world exportable coffee produced averaged 37,671,000 bags of 132 pounds each. Since annual consumption over 1930-39 averaged only 26,474,000, world visible stocks in producing countries soared to a peak of 30 million bags and would have gone much higher except for the coffee destruction program instituted by Brazil in an effort to cope with unmanageable supplies. Under this program more than 78 million bags of coffee were burned over a period of a decade and a half.

Reflecting the law of supply and demand, coffee prices fell to what were, for the producers, disastrous lows. As shown by the first chart, the New York spot price for Santos 4s during the '30s averaged around 10 cents, and at the lowest went below 5 cents.

The Situation Reversed

These distressing conditions — reminiscent of similar hard times in our own agricultural areas — had their effect in swinging the pendulum. Many coffee farmers in Brazil abandoned their plantations or uprooted their trees and turned to more profitable crops, notably cotton and foodstuffs. The Government levied taxes on new plantations of coffee trees. The number of trees, which had reached a peak of almost 3 billion in 1933, tended downward to a low of 2.2 billion in 1942, a decrease of about one-fourth.

Green coffee production declined sharply. By the early '40s it had, as the foregoing chart shows, fallen below consumption. Though production and consumption both declined during the war, the fall in production was the greater, leaving an excess of consumption which has continued during the postwar period.

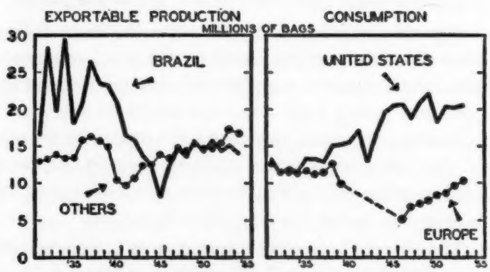
How drastically the situation changed is revealed by the following figures:

For the first seven postwar years (1945-46 through 1951-52) world exportable production of coffee averaged 28,961,000 bags— a substantial recovery from the wartime low, but a decline of 23 per cent from the average of the '30s. During this same period world consumption rose to an annual average of 30,684,000 bags — an increase of 16 per cent over the '30s. Thus from 1946 through 1952 there was an annual average deficit in production of 1,723,000 bags. Stocks accumulated from the years of overproduction were steadily drawn down, and by 1949 were back to the level of the '20s when world consumption was much lower.

Again the law of supply and demand was reflected in the market place, but this time in the opposite direction. With the removal of price ceilings in this country after the war, coffee prices began to discount the changing statistical position and outlook. Step by step with declining excess stocks the price continued to rise, culminating in the sharp advance of 1949 from 26c in April to 52½c in November. In 1950 spot prices for Santos 4s averaged 51 cents.

World Coffee Trends by Major Areas

A major factor in the failure of world coffee production to keep pace with rising consumption has been the relatively slow comeback in Brazil. As shown below, production of countries other than Brazil has increased steadily since 1940 and in the years 1945-46 through 1951-52 averaged 14,580,000 bags, or 3 per cent above the average of the '30s.



Annual Production and Consumption of Green Coffee by Major Areas

Outside Brazil, larger exportable crops during recent years in Colombia, Mexico, and Africa have more than offset declines in Indonesia, Venezuela, Peru, and in Cuba. Exportable out-

put of other Latin-American countries generally has remained about the same or shown a slight upturn.

Particularly noteworthy has been the production rise in Colombia, the world's second major coffee-producing country. She has boosted her exportable crop from a pre-World War II average of 3.8 million bags to around 5.5 million currently, an increase of 45 per cent. In addition, that country has augmented world coffee supplies during the past two years by selling stocks previously accumulated through domestic price-propping measures. In 1952-53 Mexico produced a record exportable crop of over 1.2 million bags, against her prewar average of 675,000, which made her the third ranking world producer last year. High prices have also stimulated production in Africa where output has increased to around 5 million bags annually, nearly double the prewar high.

At the same time, average annual production in Brazil, though almost as large as that of the rest of the world combined, has been running some 40 per cent below the average of the '30s.

That the recovery of Brazilian production lagged in this fashion is not difficult to understand. The effects of the neglect of coffee trees during the depression, and of the efforts at diversification both agriculturally and industrially, are not quickly overcome. The lag has been particularly marked in some of the older producing areas because of worn out soil and advancing age of the trees. While the rising prices of the late '40s and the '50s have stimulated a marked increase in plantings in important new areas being opened up for cultivation, it takes time, as previously indicated, to bring these new trees into full production.

Meantime — on the side of consumption — demand in the United States has, as the last chart also shows, continued at high levels, up 46 per cent from prewar. At the same time, European consumption is coming back from the wartime lows. From a total of 5,176,000 bags in 1946 green coffee imports by Western European countries rose to an estimated 10,200,000 bags in 1953. Thus, Europe is competing actively for world coffee supplies.

Effects of July '53 Frost Damage in Brazil

It was in the face of this already tight supply-demand situation that news broke in July of serious frost damage to Brazilian coffee trees.

Estimates made early in 1953 placed world exportable production of coffee for the 1953-54 crop year (ending June 30, 1954) at 33,011,000 bags. Of this total, it was anticipated that Brazil would contribute 16,939,000 bags, or over 50 per cent. World production and consumption were expected to be almost in balance.

But on July 5 word came from Brazil of a severe frost, particularly in the State of Parana, where the bulk of the new planting has been done. At first there was considerable skepticism in world coffee markets as to the damage actually done. However, as it became possible to assess the damage more fully, its seriousness became increasingly apparent. As a result, estimates of Brazil's exportable production for the 1953-54 crop were revised downward to 14,006,000 bags — a drop of 2,933,000 bags. To further add to the gravity of the situation the next crop (1954-55) is currently placed at only 12,700,000 bags which is 5,200,000 bags below the original estimate.

The following table gives the latest estimates for Brazil for the crop years 1953-54 and 1954-55, compared with actual results for 1952-53, as compiled by the Brazilian Coffee Institute and the Pan-American Coffee Bureau:

Brazilian Coffee: Supply and Disappearance

(Thousands of bags, 132 lbs. each)

	Actual	1953-54 Estimates		Expected
	1952-53	Pre-frost	Post-frost	1954-55
Visible carryover (July 1)	2,956	2,950	2,950	1,500
Registered from previous crop	59	17	17	—
Indicated new crop	15,829	16,939	14,006	12,700
Available supply	18,844	19,906	16,973	14,200
Coastwise shipments and port consumption	926	—	950†	—
Exports	14,968	—	14,523*	—
Visible carryover (June 30)	2,950	—	1,500	—

* Based on reduction in carryover to 1.5 million bags.
† Estimated.

It will be seen that unless unreported stocks of coffee in the interior are larger than generally believed in the trade, Brazil will be able to maintain exports this year at close to last year's level only by drawing down carryover stocks to the abnormally low total of 1,500,000 bags next July 1, against 2,950,000 a year earlier. Although subject to revision, realization of a 1954-55 crop no larger than the current official estimate of 12.7 million bags indicates even greater tightness of supplies in the year following July 1.

Charges that coffee-growing countries are holding back supplies are not substantiated by the rate of exports during the first seven months of the current crop season (July 1 through Jan. 31, 1954). Exports of coffee from Brazil during this period, despite the short crop, totaled 10,318,000 bags, 457,000 above the same period in 1952-53. Colombia in the same period exported 4,227,000 bags, 1,035,000 greater than a year

earlier. Brazilian port stocks, as of February 1, 1954, totaled 3,243,000 bags, down 743,000 from a year ago. Charges of withholding supplies come with bad grace from the United States, considering its immense store of farm commodities withheld from the market under official price support programs.

Stocks of green and roasted coffee in the hands of U.S. importers and roasters, as of February 1, were placed at around 4 million bags, about a two months' supply. This is closely in line with average stocks at this season for the past few years, notwithstanding the indicated outlook for smaller supplies during the next 18 months.

Since Brazil has been contributing nearly half of the world's exportable production of coffee, she is the key to the present situation. Estimates of world available supplies have had to be cut sharply. In these circumstances, the price rise is no mystery, but merely reflection of the law of supply and demand working again to rectify an unbalanced situation. Meantime, any additional dollars earned by producing countries as a result of higher prices for coffee will, of course, put these countries in a position to import more goods from the United States.

Services of Speculation

As for the charge of "speculation", it would be unrealistic not to recognize that this has entered the picture. But how much speculation there has been and how much effect it has had would be difficult to say.

In the first place, the line between what is and what is not "speculation" is often a hard one to draw. Everyone who buys and sells on a commodity exchange for future delivery, whether he be a professional speculator, a wholesaler, or a manufacturer, has some effect in determining prices, and all of such operations involve some element of risk, hence of speculation. The question is, who shall carry these risks? There is where the so-called "speculators" come in. Their operations play an essential role, broadening the market, and facilitating "hedging" by importers, processors, wholesalers, and others against unpredictable price changes, through sale of contracts for future delivery to these speculators who are willing to assume market risks in the hope of making a profit.

Secondly, it cannot be assumed that all speculators are always on the same side of the fence. While some may be buying in anticipation of a rise, others — particularly in the later stages of a bull market — may be selling in anticipation of a fall. To the extent that shrewd and experienced traders buy when prices go too low and sell when they go too high, their operations tend to dampen rather than augment extreme fluctuations.

Usually, there is a good reason for major price swings, such as we have seen in coffee. The sooner the corrective price movement takes place, the better. In the case of coffee, railing at speculators for putting up prices accomplishes nothing towards curing the underlying shortage. A rise in the price does. As Professor Sumner Slichter of Harvard University recently declared,

> If private speculators are using their own funds and credit to push up the price of a commodity that is in short supply, their attempts to make a profit for themselves have the unintentional effect of performing a public service. The consumption of commodities that are in short supply needs to be discouraged, and the production of them needs to be encouraged. The more promptly the shortage of supply is recognized and the price bid up, the more quickly the needed adjustments come about.

The "Middleman" Exonerated

Our readers may recall complaints last fall over prices — at that time by domestic cattle raisers because of low cattle prices and by some consumer groups because of the alleged failure of meat prices to reflect the decline in live beef prices. Once more was raised the old outcry against the "excessive" profits of the traditional villain — the "middleman". The following excerpt from the New York Times of September 21, reporting on a Congressional committee then touring the country to sound out sentiment on farm policy and programs, is a typical example:

> Farmers and farm organization representatives from Southern states have been telling the committee members that "something is wrong somewhere" in the meat industry. Some blame the packers, others the distributors, and a few the retail markets. . . . One beef and tobacco farmer in Virginia said "it can be assumed that the packer is getting more than he is entitled to."

Under pressure by spokesmen for livestock and consumer groups, notably labor, the Department of Agriculture undertook an investigation of marketing spreads during the period in question. Its report, released in December, is deserving of attention in view of the fanfare over the original charges.

The Department exonerated the packers, wholesalers, and retailers of meat. It found no profiteering and said that the middlemen were not to blame for cheap cattle. The report stated:

> Declining cattle prices in the latter half of 1952 and in 1953 were caused primarily by increasing cattle slaughter as the cattle cycle approached the end of its expansion phase. The widening of the spreads between grades,

in the fall months of 1952 and 1953, caused the declining cattle prices to bear most acutely on lower grades of cattle. The widening price spreads between grades were primarily caused by the changing character of the marketings, the increasing proportions of unfinished young stock and of surplus cows off grass in the total slaughter, as the cattle cycle approached the end of its expansion phase.

The report also said:

It appears that the declining prices for cattle, especially for the lower grades, were not caused primarily by a widening of marketing margins. The overall farm-to-retail marketing margin for U.S. Choice beef was at a high in 1952, but declined in 1953 . . . It does not appear that the $11 price drop, from the January 1952 price of $22 for Utility cows at midwestern markets to the September 1953 price of $11, could have been affected by changes in margins in either direction by more than $0.75 to $1.00 per 100 pounds.

Consumer Partly Responsible

Part of the apparent discrepancy between retail prices and farm prices, the report stated, is attributable to the meat-buying habits of the consumer. Most consumers, it was indicated, buy U.S. Choice or Good beef, and stores tend to stock only one grade which their customers accept. A sudden increase in the supply of low-grade or Utility beef, such as occurred last fall, therefore finds a limited market because most consumers do not readily shift quality in their meat purchases. The result is that the low-grade beef cuts go down sharply in price while the good grades are much less affected.

In other words — putting it more bluntly — in these days of prosperity and high incomes most consumers want only the best, hence pay more than if they were willing to buy the lower-grade, but still nutritious, cuts. At the same time the cattle raiser gets less, to the extent that what he has to sell is the lower-grade product.

Other Marketing Rigidities Cited

The report also made the point, familiar to every business man, that in the food industry, as in other lines, many costs other than those of raw materials enter into the finished product. What the farmer gets for his cattle is, so to speak, only the raw material cost; to this must be added transportation, slaughter, storage, and selling costs before the product reaches the consumer. These costs do not drop sharply merely because cattle prices decline, since the wages and materials that go into transport, processing, and selling remain much the same, if indeed they do not actually increase. Because of their comparative rigidity, such costs tend to increase percentagewise as cattle prices fall.

In this respect, livestock producers are in the same position as mineral, timber, or other raw material producers. Prices of their raw products advance more sharply than those of finished products during tight supply, and drop more sharply during ample supply. This is one of the characteristics of the business, and those who engage in it must take the bitter with the sweet.

The Department of Agriculture did not attempt to study the net profits of marketing agencies. In the case, however, of the meat packing industry — a frequent butt of political attack over the years — our own tabulations show the following record of earnings rates of leading companies, compared with the manufacturing industries generally, through 1952, the latest available:

Net Income After Taxes, as Percentage Rates of Return on Net Assets and Profit Margins on Sales, Reported by Leading Companies in Meat Packing and in the Manufacturing Industries Generally

	% Return on Net Assets		% Margin on Sales	
Year	Meat Packing	Total Mfg.	Meat Packing	Total Mfg.
1943	7.9	9.9	1.1	3.6
1944	7.6	9.8	0.9	3.2
1945	5.4	9.1	0.9	3.9
1946	10.8	12.1	1.7	6.0
1947	12.0	17.0	1.4	7.1
1948	7.2	18.9	0.7	7.5
1949	3.8	13.8	0.5	6.8
1950	6.4	17.1	0.3	7.7
1951	5.5	14.4	0.6	6.2
1952	3.8	12.3	0.4	5.4
10-year Average	7.0	13.4	0.9	5.7

Clearly, profits in meat packing are modest compared with those of manufacturing in general. In the case of profits relative to sales, the low margins in meat packing are proverbial, averaging less than one cent per sales-dollar.

Example of Potatoes

Several years ago, when the Federal Government was having its troubles getting rid of a mountain of potatoes it had bought up to support the price, it offered to give the New York City Welfare Department a substantial part of its stock free, if the Department would come and get it. The City found it couldn't afford the potatoes even as a gift. Freight, packaging, storage, and other expenses were too much. As the Wall Street Journal remarked at the time, "Maybe the poor middleman is worthy of his hire after all."

The same principle goes for beef. On the hoof it is not the same as sirloin steak on the table, any more than a potato in the patch is the same as "French-fries", or a steel ingot the same as an automobile.

Printed in U.